No. 83-653

In the Supreme Court of the United States

October Term, 1983

LEATHERBY INSURANCE COMPANY, a/k/a WESTERN EMPLOYERS INSURANCE COMPANY,
Petitioner,

vs.

MERIT INSURANCE COMPANY,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF

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AUTHORITIES CITED

Cases

Rule

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Merit Insurance Company's brief in opposition to the petition herein erroneously seeks to discourage Supreme Court review by depicting the instant case as one that is procedurally flawed and thus unsuitable for consideration by this Court. As shown below, the procedural flaws that Merit relies on do not exist. Rather this case presents a straightforward legal issue of great importance to the future of arbitration.

The single dispositive question in this case is whether an arbitration award must be vacated if a neutral arbitra-

tor has failed to disclose his prior non-trivial relationship with one of the parties to the arbitration.* In *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145 (1968), this Court recognized that such disclosure is a basic safeguard of the arbitration process and that, as a practical matter, vacatur of the arbitration award is the only remedy that will deter nondisclosure. Here the district court properly applied *Commonwealth Coatings* to vacate the award, after it found not only a failure to make the necessary disclosure but also a deliberate effort to cover up that failure during the arbitration and before the district court (Dist. Ct. Opn., App. at 20, 22, 31). This remedy was necessary to protect the fundamental fairness of the arbitration process, and it worked no injustice on Merit.** The Court of Appeals' reversal of the district court's decision effectively abrogates *Commonwealth Coatings*.

Merit's brief obscures the nature of the Court of Appeals decision. It creates the impression that the Court of Appeals faithfully applied the rule of *Commonwealth Coatings* and simply concluded that the undisclosed relationship was, in Merit's often repeated phrase, "stale, limited and non-pecuniary." On the contrary, the Court

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* Contrary to Merit's suggestion, LIC has never contended that "an arbitrator's failure to disclose *any* prior association between a party and an arbitrator, no matter how impersonal, distant and stale, requires vacation of an award" (Respondent's Brief in Opposition at 16, emphasis in original).

** A party with whom the neutral arbitrator has a prior relationship assumes the risk of vacatur if no disclosure is made by the arbitrator or the party. Here Jerome Stern, Merit's president who is also an attorney, chose Clifford as a neutral arbitrator with full knowledge that Clifford had been his subordinate at Cosmopolitan Insurance Company (HT 220). Stern also testified in the arbitration on approximately thirty different occasions without ever revealing his prior relationship with Clifford (*e.g.*, Stern: Arb. T 121-28).

of Appeals ignored and supplanted the factual findings of the district court, injected inappropriate economic notions into the analysis, and enunciated standards that are wholly inconsistent with *Commonwealth Coatings* and its progeny. (Petition at 10-16, 23-24). The Court of Appeals decision should not be permitted to stand.

Instead of confronting the policy arguments recognized by *Commonwealth Coatings* and set forth in petitioner's brief, Merit successfully confused the Court of Appeals with several arguments relating to Rule 60(b) and attempts to do the same thing here. LIC's petition cut through this confusion and clarified the criteria for granting a Rule 60(b)(6) motion and for appellate review of the district court's discretionary decision. In its brief in opposition, however, Merit never addresses these criteria. Instead, Merit relies on the same evidentiary issue that led the Court of Appeals astray and additionally relies on a mechanical reading of another section of Rule 60(b).

Merit claims—and the Court of Appeals seemingly agreed (App. at 16)—that LIC should have had testimony from its "officers" regarding LIC's lack of knowledge about the Clifford-Stern relationship. In the circumstances of this case, LIC had no duty to introduce this type of evidence. Moreover, Merit never raised this issue until it was before the Court of Appeals. If Merit had believed the lack of knowledge of LIC's "officers" to be an issue during the evidentiary proceedings before the district court, it could easily have inquired into it. As the district court observed, "no restrictions whatsoever were imposed on Merit with respect to the persons that it could subpoena or call as witnesses. . . . Ample opportunity existed for counsel to ask when Leatherby or its representatives first learned of Mr. Clifford's prior association with Mr. Stern . . ." (Dist. Ct. Opn., App. at 36).

In any event, based on affidavits and live testimony, the district court found that "Leatherby and its attorneys and

agents were unaware of Mr. Clifford's prior associations with . . . Jerome Stern'' and did not learn about them until April of 1982, six months after the arbitration award was confirmed (Dist. Ct. Opn., App. at 24). Contrary to respondent's claim, the record confirms the correctness of the district court's ruling.

The lawyer charged by LIC with selecting the arbitrators and conducting the arbitration testified that he had conferred with LIC's general counsel about choosing arbitrators, had investigated the background of Clifford, and neither knew nor was informed of Clifford's relationship with Stern before April of 1982 (HT 477-481, 497, 517). Moreover, when Merit suggested that LIC's expert might have known about the Clifford-Stern connection, LIC put the expert on the stand to deny any such knowledge (HT 424).

The most telling support in the record for the finding that LIC lacked knowledge of the undisclosed relationship before the Spring of 1982 is the course of these proceedings themselves. There was no conceivable reason for LIC to hoard such knowledge through the entire arbitration proceeding and through the confirmation proceeding (where LIC unsuccessfully claimed that the arbitrators were biased), in order to use it in one last, quixotic attack on the award under Rule 60(b)(6). The district court, which as Merit concedes had ''exhaustively reviewed the entire arbitration record'' in the confirmation proceedings (Respondent's Brief in Opposition at 4), was surely entitled to draw a common-sense inference from this information. The totality of the evidence supports the district court's finding and clearly was enough to satisfy the Court of Appeals' concern that LIC ''negate any inference that it had implicitly consented to have Clifford as an arbitrator knowing all it now knows but saying nothing'' (7th Cir. Opn., App. at 16-17).

Merit also relies on LIC's alleged failure to exercise the "due diligence" required by Rule 60(b)(2) in investigating Clifford's background. Merit's "due diligence" argument is defective for several reasons. First, Merit made this same argument before the district court and the Court of Appeals, and neither court treated this as a Rule 60(b)(2) case (Dist. Ct. Opn., App. at 24; 7th Cir. Opn., App. at 16). LIC's motion was not based on Rule 60(b)(2) because the Clifford-Stern relationship was not evidence, "newly discovered" or otherwise, going to the merits of the arbitration decision. Instead, LIC's motion raised a new issue that went to the integrity *ab initio* of the arbitration process. As in the cases where a juror is later found to have failed to disclose material information on *voir dire*, Rule 60(b)(6) is the appropriate vehicle to reopen the proceedings. *See, e.g., Consolidated Gas & Equipment Co.* v. *Carver*, 257 F.2d 111 (10th Cir. 1958); *McCoy* v. *Goldstein*, 652 F.2d 654 (6th Cir. 1981) (*semble*).

Second, Merit's theory ignores who has the burden of disclosure. LIC had no duty to search out information about Clifford's association with Stern. Rather, it was Clifford's unquestioned responsibility to disclose that information.

Third, even if "due diligence" were required, the district court found that, "[a]lthough I believe that due diligence in bringing this motion or in pursuing a prior investigation of Mr. Clifford was not required, there is no showing that due diligence was lacking here" (Dist. Ct. Opn., App. at 24).

The Court of Appeals made of Rule 60(b)(6) something that it is not, by reading into it requirements that are irrelevant to its very nature and inconsistent with the substantive law on arbitrator disclosure. The district court acted well within its discretion pursuant to Rule

60(b)(6) in deciding that LIC's allegations were sufficiently grave to warrant reopening the confirmation proceedings (Petition at 21-23). Following a full evidentiary hearing, the district court decided that, under *Commonwealth Coatings*, a new arbitration was required. Both the procedural and substantive decisions were based on a sound weighing of the equities, as the district court indicated:

> This Court is not unmindful of the length of the arbitration proceeding, nor the work that went into it, nor the importance to both sides of the award which was made, and later confirmed by me, but none of that can stand in the face of a record which disclosed a flaw, manifested from the beginning, characterized by deceit and fundamentally adverse to the notion of a fair and impartial proceeding. [Dist Ct. Opn., App. at 30-31].

None of Merit's attempts to cloud the real issues in this case should deter this Court from granting a writ of certiorari to review the decision of the Court of Appeals for the Seventh Circuit and restoring integrity to the arbitration process.

DATED: November 22, 1983

Respectfully submitted,

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